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Valuation Interest Rate

A valuation interest rate of 5% was used. This is the rate used in the most recent Foreign Service valuation and is consistent with rates currently being considered for long range projections by Social Security and Civil Service.

Normal Cost

Normal cost can be defined as the total level percentage of an employee's salary required to finance the benefits which he is expected to receive from the system. If such a percentage of salary (regardless of source) were constantly set aside from the time the employee entered the service until the time he was separated from active service, it would accumulate at the valuation interest rate to an amount sufficient to provide his annuity or other benefits to which he or his survivors are entitled. (A part of the total normal cost is provided by employee contributions, transfer of employee contributions from Civil Service, agency contributions, appropriations, etc. Interest earned by the fund or appropriated interest on the unfunded liability is not part of the total normal cost.)

Below are given normal cost distributions as of December 31, 1968, adjusted to June 30, 1970, in order to reflect the benefit and contribution changes provided by PL 91-185. The lower part of the table shows the source of the normal cost. The item, "Transfer of member contributions from Civil Service" requires explanation. The figure of 2.88% means that the lump sum transfer of employee contributions is equivalent to 2.88% of the employee's future salary. In other words, this much of the total normal cost is provided by a lump sum transfer whereas the two 7% contribution items come in as a steady percentage of future payroll as does (for this purpose) the residual normal cost.

As a part of this valuation a determination of the normal cost was made on the assumption of an annual increase in salaries of $3\frac{1}{2}\%$ and an annual increase in the cost-of-living index of $1\frac{1}{2}\%$. On these assumptions it was found that the normal cost is about $1\frac{1}{2}$ times what it is on a static basis. Instead of 31.34% it would be about 47% on these dynamic assumptions. Realistically, it should be borne in mind that on a normal cost basis assuming salary and cost-of-living increases, the cost of retirement system benefits runs close to 50% of salary. This concept of financing (normal cost as percentage of current pay) is about as conservative as any basis should be. The least conservative method is "pay as you go", in which benefits are not financed as they are earned but are paid when they fall due. The normal cost approach is excellent for comparing the relative costs of different retirement systems, provided the same valuation rate of interest is used.

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Comparison with Civil Service System Normal Cost

Currently the Civil Service normal cost is estimated at about 14% of payroll, based on a valuation rate of $3\frac{1}{2}\%$. If a valuation rate of $3\frac{1}{2}\%$ were used on the CIA system total normal cost would increase from 31.34% to roughly 46%. The question arises as to why the rate under CIA is so much higher than under Civil Service. The reasons are listed as follows:

1. The average entry age of about 36 years for CIA is much higher than the average entry age for Civil Service, which is in the vicinity of 27 years. This is caused partly by the fact that personnel must serve for 5 years under the Civil Service system before coming under the CIA system. The average retirement age under CIA is approximately $57\frac{1}{2}$ years. Under Civil Service it is about $60\frac{1}{2}$ years. A lower retirement age combined with a higher entry age contributes directly to higher normal cost, particularly when prior service is credited.
2. The resignation or turnover rate is much lower under CIA. The percentage of new entrants into CIA who stay until retirement ranges from about 63% for entrants at age 30 to 84% for entrants at age 51. Under Civil Service only about 15% of the new entrant males at age 27 are still in service at age $57\frac{1}{2}$ and only 4% of the new entrant females are still in service at age $57\frac{1}{2}$. Because of this, the ratio of benefits to salary earned is much greater under CIA. This relation translates to normal cost, which is the ratio of the present value of benefits for a new entrant divided by the present value of his future salary.
3. The salary scale under CIA is much steeper than under Civil Service. Since annuities are based on the final 3-year average, the ratio of benefits to contributions is higher using a steeper salary scale. Under CIA, a cross-section of salaries for participants of all ages shows that the average salary at age $57\frac{1}{2}$ is 2.2 times the salary at age 30. The Civil Service salary scale shows a ratio of only 1.4 for the same two ages.
4. The formula for computing annuities under CIA is based on a flat 2% per year of service, whereas under Civil Service less credit is given for the first 10 years.

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Financing Considerations

The table on page 11 shows a projection of future receipts and expenditures of CIARDS under three different financing assumptions starting with salaries for the fiscal year 1969. This projection does not reflect salary and cost-of-living increases since December 31, 1968 nor does it assume any future salary or cost-of-living increases. To this extent it is unrealistic and probably unduly pessimistic in its forecast of future operations.

The right hand column of the table shows that under the present basis the Fund, supported by matching agency-employee contributions, would go broke after 1988 under static assumptions. Because of legislation enacted and contemplated which will provide additional financing, no effort was made to determine the life of the Fund on the existing basis using dynamic salary and cost-of-living assumptions.

The next to last column of the table shows a projection of the Fund, on static assumptions, on the basis of financing provisions now contained in the Civil Service and Foreign Service Acts. As shown by footnote "f", interest on the unfunded liability and payment of annuities based on military service would be provided automatically by the Treasury. Under such conditions the Fund would hold out until after 2028. A projection of the Foreign Service system shows similar performance. However, under dynamic assumptions (3 $\frac{1}{2}$ % annual salary increases and 1 $\frac{1}{2}$ % annual cost-of-living increases) the Foreign Service fund continues to grow beyond the year 2050. Under similar dynamic assumptions the CIA fund could be expected to perform much the same as Foreign Service and continue to grow indefinitely.

The third from the last column shows the projected Fund on static assumptions but with full financing of normal cost and interest on the unfunded liability.

There are those who feel that the CIA and Foreign Service systems should be financed on a full normal cost basis. Others advance the counter argument that these systems are really part of the overall Government civilian system and should be financed at the same contributory level with supplemental appropriations when and if needed. They point out that much of the service credit is carried over from the Civil Service system and that the benefit provisions differ very little from some of the specialized categories under Civil Service.

With legislation recently enacted for transfer to the fund of employer contributions to match employee contributions for creditable service under Civil Service, and assuming legislation to provide financing provisions similar to those contained in the Civil Service and Foreign Service Acts (and employing the same agency-employee matching percentages), the CIA system should have no financial problems in the foreseeable future.